

# **REPORT OF THE AUDITOR-GENERAL TO THE NORTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON UBUNTU LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the financial statements of the Ubuntu Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and budget statement for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-General's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### **Basis for qualified opinion**

#### **Revenue from non-exchange transactions**

6. I was unable to obtain sufficient appropriate audit evidence for revenue from fines for current and prior year as the municipality did not have adequate systems to maintain records of fines. I could not confirm the revenue from fines by alternative means. Consequently, I was unable to determine whether any adjustment to the revenue from fines stated at R52 473 517 (2013: R16 010 910) in the financial statements was necessary.

7. I was unable to obtain sufficient appropriate audit evidence that management had properly levied and accounted for all property rates for the current year, due to the status of the accounting records. I was unable to confirm the property rates by alternative means. Consequently, I was unable to determine whether any adjustment to property rates stated at R2 441 770 in the financial statements was necessary.

#### **Receivables from non-exchange transactions**

8. I was unable to obtain sufficient appropriate audit evidence regarding receivables from non-exchange transactions and related provision for doubtful debts for current and prior year due to the status of the accounting records. I was unable to confirm the receivables from non-exchange transactions and the related provision by alternative means. Consequently, I was unable to determine whether any adjustment relating to receivables from non-transactions stated at R18 538 474 (2013: R14 933 536) and the related provision stated at R45 362 347 (2013: R8 227 880) in the financial statements was necessary.

#### **Expenditure**

9. I was unable to obtain sufficient appropriate audit evidence regarding operating expenditure as payment support for expenditures made was not provided. I was unable to confirm operating expenditure by alternative means. Consequently, I was unable to determine whether any adjustment relating to operating expenditure stated at R35 776 190 in the financial statements was necessary.

#### **Capital Commitments**

10. I was unable to obtain sufficient appropriate audit evidence regarding capital commitments due to capital commitments disclosed not being supported with appropriate records. I was unable to confirm capital commitments by alternative means. Consequently, I was unable to determine whether any adjustment relating to capital commitments stated at R12 723 000 in the financial statements was necessary.

#### **Aggregation of immaterial uncorrected misstatements**

11. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items making up the statement of financial position/and the statement of financial performance and the notes to the financial statements:

- Revenue from exchange transactions reflected as R19 877 208 was misstated by R765 514.

In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:

- Property, plant and equipment of R1 019 350 as included in the disclosed balance of R1 019 350.
- Contingent liabilities of R328 410 as included in the disclosed balance of R328 410.
- Leave liability of R70 863 as included in the disclosed balance of R1 449 419.

As a result, I was unable to determine whether any adjustment to these items was necessary.

#### **Qualified opinion**

12. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Ubuntu Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

#### **Emphasis of matters**

13. I draw attention to the matters below. My opinion is not modified in respect of these matters.

#### **Significant uncertainties**

14. With reference to note 51 to the financial statements, the municipality is the defendant in multiple-claim lawsuits. The municipality is opposing some of the claims as it believes the claims to be winnable in favour of the municipality. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

#### **Restatement of corresponding figures**

15. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of an error discovered during 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

#### **Material impairments**

16. As disclosed in note 31 to the financial statements, material impairments to the amount of R33 331 794 (2013: R8 322 367) were incurred as a result of a write-off of irrecoverable trade debtor.

#### **Material losses**

17. As disclosed in note 43.4 to the financial statements, material losses to the amount of R13 922 956 (R13 164 918) and were incurred as a result bulk electricity and water purchases.

#### **Financial sustainability**

18. Note 53 to the financial statements indicates that the municipality incurred a net surplus of R3 901 921 during the year ended 30 June 2014 however, as of that date, the municipality's current liabilities exceeded its total assets by R4 144 303. These conditions, along with other matters as set forth in note 51, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

#### **Additional matters**

19. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Unaudited disclosure notes**

20. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

### **Unaudited supplementary information**

21. The supplementary information set out on pages 77 to 85 does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

### **Supplementary explanations of budget variances presented outside the financial statements**

22. The supplementary explanations of budget variances contained in Appendix E, do not form part of the financial statements. I have not audited these explanations and accordingly I do not express an opinion thereon.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

23. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### **Predetermined objectives**

24. I am unable to report on the usefulness and reliability of the performance information, as the annual performance report of the municipality was not prepared as required by section 46 of the Municipal Systems Act and section 121(3)(c) of the MFMA.

### **Compliance with legislation**

25. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA are as follows:

### **Strategic and performance management**

26. The adopted integrated development plan (IDP) did not reflect and identify the development priorities or objectives, the key performance indicators and targets, as required by sections 26 and 41 of the MSA, as well as Municipal planning and performance management regulation 2(1)(c).
27. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
28. The municipality did not give effect to its integrated development plan and conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.

29. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
30. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
31. Key performance indicators, including input, output and outcome indicators, in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and the Municipal planning and performance management regulation 1 and 9(1)(a).
32. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
33. The performance of the municipality were not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.
34. The annual performance report for the financial year under review was not prepared and was not included in the annual report , as required by section 46 of the MSA and section 121(3)(c) of the MFMA.
35. The annual performance agreements for the municipal manager and all senior managers are not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.
36. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

### **Budget**

37. The total unforeseen and unavoidable expenditure incurred exceeded 5% of own revenue in contravention of Municipal Budget and Reporting Regulation 72.
38. Expenditure was approved as unforeseen and unavoidable which was considered by the council but not included in the approved annual budget, in contravention of Municipal Budget and Reporting Regulation 71(2).
39. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

### **Annual report and annual financial statements**

40. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. The uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
41. Oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2012/13 annual report was tabled, as required by section 129(1) of the MFMA.

### **Audit committee**

42. A performance audit committee was not in place and the audit committee was not used to fulfil the performance audit committee function, as required by Municipal planning and performance management regulation 14(2)(a).
43. The audit committee did not advise the council and accounting officer on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management, performance evaluation as required by section 166(2)(a) of the MFMA.
44. The audit committee did not advise the council and accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
45. The audit committee did not advise the council and accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
46. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2) (c) of the MFMA.
47. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the Municipal Finance Management Act.

### **Internal audit**

48. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
  - It did not report to the audit committee on the implementation of the internal audit plan.
  - The internal audit unit did not report to the audit committee on matters relating to compliance with the MFMA, the DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

### **Procurement and contract management**

49. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
50. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a)
51. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
52. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
53. The municipality did not implement an SCM policy as required by section 111 of the

MFMA.

#### **Human Resource management**

- 54. An acting section 57 employee was appointed for a period of more than three months without the approval by the MEC for local government in contravention of section 54A (2A) of the MSA.
- 55. The municipality did not develop and adopt appropriate systems, policies and procedures to monitor measure and evaluate performance of staff in contravention of MSA sec 67(d).
- 56. Bonuses were awarded to the municipal manager and senior managers directly accountable to the municipal manager without performance contracts in place which was in contravention of section 57(4)(b) MSA.
- 57. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor measure and evaluate performance of staff in contravention of MSA sec 67(d).
- 58. The municipal manager and senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) MSA.

#### **Expenditure management**

- 59. Money owed by the municipality was not always paid within 30 days, as required by section 65(2) (e) of the MFMA.
- 60. Sufficient appropriate audit evidence could not be obtained that payments from the municipality's bank account were approved by the accounting officer, as required by section 11(1) of the MFMA.
- 61. An effective system of expenditure control, including procedures for the authorisation of funds, was not in place, as required by section 65(2) (a) of the MFMA.
- 62. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA.

#### **Revenue management**

- 63. An adequate management, accounting and information system which accounts for revenue, debtors, receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
- 64. An effective system of internal control for revenue was not in place, as required by section 64(2) (f) of the MFMA.

#### **Liability management**

- 65. Short-term debt was incurred without a resolution of the municipal council approving the debt agreement, in contravention of section 45(2) (a) of the MFMA.

## **Consequences Management**

66. There is no evidence that unauthorised, irregular, fruitless and wasteful expenditure incurred by the municipality was investigated to determine if any person is liable for the expenditure, as required by section 32(2) (a) (ii) of the MFMA.

## **Internal control**

67. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on non-compliance with legislation included in this report.

## **Leadership**

The following root causes were identified for the deficiencies identified in the internal controls:

68. The leadership did not take appropriate action with regard to a lack of controls in the finance and supply chain management directorates, resulting in non-compliance with applicable legislation and inadequate budget control measures. This, in turn, resulted in irregular, fruitless and wasteful as well as unauthorised expenditure being incurred.
69. The leadership did not take appropriate action with regard to a lack of controls in the finance and supply chain management directorates, resulting in non-compliance with applicable legislation and inadequate budget control measures. This, in turn, resulted in irregular, fruitless and wasteful as well as unauthorised expenditure being incurred.
70. Leadership did not regularly monitor management's compliance with laws, regulations and internally designed policies and procedures. As a result, significant non-compliance issues were noted.
71. Leadership did not intensify its drive to address all material and non-material findings reported in previous audit. There was a sense of complacency displayed as result of better opinion obtained the previous financial year.
72. There was lack of attention by the leadership to address issues relating to IT matters.

## **Financial and performance management**

73. The underlying accounting records of the municipality did not facilitate the preparation of the financial statements to comply with the accounting framework. Documentation supporting amounts disclosed in the financial statements was not always available.
74. Controls were not designed to ensure that the transactions had occurred, were authorised, and were completely and accurately processed.
75. The municipality did not have individuals who sufficiently understand the financial reporting framework and performance and financial management requirements. This resulted in the municipality engaging a consultant to prepare the financial statements.
76. Management did not task specific individuals who will drive the matters of compliance, and this process was not continuously monitored.

77. There was lack of attention by the leadership to address issues relating to IT matters.

#### **Governance**

78. The municipality did not respond to the assessed risks by determining a risk strategy and action plan to manage identified risks. Consequently, internal controls were not selected and developed to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

79. As the internal audit services are a shared service, it would appear that financial constraint, coupled with enough resources is a driver of the lack of discharge of some of the duties.

80. The accounting officer did not prioritise the establishment of a fully functioning performance audit committee and therefore the functions were not established and functional during the financial year. This also resulted in the committee not being able to fulfil all their responsibilities.

*Auditor-General*  
Kimberley

30 November 2014



AUDITOR - GENERAL  
SOUTH AFRICA

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